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1 UNITED STATES DISTRICT COURT
2 SOUTHERN DISTRICT OF NEW YORK

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3 AVNER MALOUL and ALLEN LOWY,

4 Plaintiffs,

5 v.

07 Civ. 8525

6 IVAN BERKOWITZ, GREAT COURT
7 CAPITAL, LLC, SD PARTNERS, LLC,
8 UTIX GROUOP, INC.,
9 VSUS TECHNOLOGIES, INC.,
10 and SUNSET BRANDS, INC.,

Defendants.

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11 January 3, 2008
12 2:15 p.m.

13 Before:

14 HON. LEONARD B. SAND

District Judge

15 APPEARANCES

16 MORGENSTERN JACOBS & BLUE, LLC
17 Attorneys for Plaintiffs
18 BY: ERIC B. FISHER

19 GERSTEN SAVAGE LLP
20 Attorneys for Defendants
21 BY: STEVEN R. POPOFSKY
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1 (Case called)

2 (In open court)

3 THE COURT: You may be seated. Who speaks for the
4 movant?

5 MR. POPOFSKY: Steven Popofsky from Gersten Savage
6 LLP.

7 THE COURT: I will hear you.

8 MR. POPOFSKY: Thank you. Your Honor, there are I
9 think three things at issue on this motion. Puffing, I'm going
10 to pass by unless you have any questions. I think there are
11 certain types of representations that are not actionable,
12 they're not actionable without the need for discovery or
13 summary judgment, Bonanza, those types of things. I think I
14 will leave it to the papers on that.

15 THE COURT: OK.

16 MR. POPOFSKY: I think the more complicated question,
17 although still I think dispositive, is the question of a couple
18 of more factual representations that I say needed to be
19 verified and weren't.

20 There is a principle of law -- and the plaintiffs
21 don't dispute the principle -- that if a plaintiff has the
22 means to verify a representation and chooses not to do it, he
23 or she can't complain that they were defrauded into whatever
24 they did.

25 THE COURT: Let's talk about that for a moment. In

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1 the classic cases, the victim, the plaintiff, is told something
2 like you should invest in this company because they're about to
3 acquire something or they get a patent or do something. Right?
4 The investor is told that somebody else is going to do
5 something, or has something, some attribute or event which is
6 going to cause the investment to be of great value. And the
7 courts show very little sympathy towards the victim who doesn't
8 investigate that.

9 Now, this is a different situation, because the
10 representation which was allegedly made is not about what
11 somebody else was going to do but something that the defendant
12 said he had done or was going to do, invest an equal share of
13 his own money in the company.

14 MR. POPOFSKY: I think there are two representations
15 in this complaint that fall in that category. Your Honor
16 stated one. The other one is that there were personal
17 guarantees by the principals of the issuers. I think that does
18 fall --

19 THE COURT: Well, that comes in the first one.

20 MR. POPOFSKY: Yes.

21 THE COURT: But how about the representation by
22 somebody who is thought of as being a friend who says I have or
23 I will --

24 MR. POPOFSKY: I have.

25 THE COURT: -- I have invested a like sum of money in

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1 the company?

2 MR. POPOFSKY: On the same terms and conditions.

3 THE COURT: Yes.

4 MR. POPOFSKY: I don't see a material --

5 THE COURT: How do you verify that? When your friend
6 tells you this is what I have done --

7 MR. POPOFSKY: That's very simple. I think that's a
8 simple answer, your Honor. You ask either the person who is
9 telling you, or the company, to see the documentation of the
10 investment. The same thing that you have done, the same thing
11 that you may be expecting to receive, you ask to see something
12 that he has done. I think that's an easy request to make, it's
13 an easy thing to see. If someone has in fact invested \$100,000
14 or \$700,000 over 18 months on four separate occasions, and
15 someone is telling you he has done the same thing, it's easy to
16 say let me see some verification of that -- if he cares.

17 THE COURT: And the answer you get is "Don't you trust
18 me? I'm your friend." Right?

19 MR. POPOFSKY: Well, that's not what's alleged here.
20 What's alleged here -- the difference, your Honor -- I don't
21 know if it's a difference -- but I think the key thing is that
22 the plaintiffs in this complaint not only admit but they
23 proudly proclaim that they did nothing, they asked no
24 questions.

25 THE COURT: Because they relied on the good faith and

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1 integrity of their friend.

2 MR. POPOFSKY: That's correct. And what would be the
3 point of the principle of law that if you have the means to
4 verify you must make use of them if you can just say I could
5 have easily found this out but I relied on my friend? And they
6 didn't just rely once, your Honor. And I think that's
7 important here. This is four separate investments, according
8 to the complaint, four separate investments over 18 months.
9 So, every five months or so all of this is alleged to have
10 happened again. If they really were interested, if they really
11 cared about whether Mr. Berkowitz was coinvesting --

12 THE COURT: They were interested enough to put in the
13 money, right? This is not --

14 MR. POPOFSKY: Well, they were blindly doing,
15 according to them, whatever they were asked to do. They claim
16 that he had made money for them in the past, so they were just
17 sending money. But what I'm suggesting is I don't think they
18 were really interested in whether he was coinvesting or not.
19 But if they were --

20 THE COURT: This is a motion to dismiss a complaint.
21 What basis do they have for saying that they didn't care? This
22 one said, hey, I have done work for you in the past, here is
23 another opportunity and I am putting in X dollars; do you want
24 to put in that amount of money also?

25 MR. POPOFSKY: And then they do it, and then six

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1 months later they do it again, and then six months later they
2 do it again, and all during that time they never asked to see.
3 If that was important to them, they should have asked to see
4 some verification somewhere along the line. They also had a
5 lawyer.

6 THE COURT: Let's assume for the moment -- it's a
7 motion to dismiss a complaint, and I have to assume the facts
8 as alleged in the complaint. Why would the defendant have said
9 that to the plaintiffs other than to induce them to make the
10 investment?

11 MR. POPOFSKY: No, that would be why he would -- yes,
12 we are assuming the truth. That's why he would say it. But
13 the law requires of plaintiffs some minimal level of due
14 diligence. The cases clearly state that.

15 THE COURT: Well, do you have a case in which the
16 relationship between the plaintiff and the defendant was an
17 ongoing one, categorized by the plaintiff as being a friend, in
18 which the alleged misrepresentation is of something which the
19 defendant had done, not something that was happening to the
20 company or some third party? I your friend am telling you that
21 I am putting in X thousand dollars, do you want to put it in
22 also?

23 MR. POPOFSKY: Well, first of all, we're not talking
24 about an allegation of any fiduciary relationship. And the
25 allegation in the complaint is not that they were friends; it's

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1 that he said as your friend I'm telling you this. No, I don't
2 believe I have a case that specifically says that someone who
3 characterized himself as a friend said it, but I don't think
4 the case law is so limited.

5 THE COURT: Do you have a case in which the
6 misrepresentation is with respect to something that the
7 defendant said he had done?

8 MR. POPOFSKY: I'm not sure, your Honor. I would have
9 to look, because until you raised that as a distinction -- it
10 was not raised in the opposing brief, and it's not a
11 distinction that I had thought about. I would have to look.

12 THE COURT: I will give you an opportunity to think
13 about it, because I haven't either.

14 It occurred to me, however, that in a way people deal
15 with each other there may be -- and I am not at all adamant
16 about this -- when somebody in a professional context says that
17 he has done something, he has done something which makes you
18 eager to get on the same band wagon, and he had not done it,
19 I'm not aware of any case.

20 MR. POPOFSKY: I understand that point. I just don't
21 see why that's a legal principle distinction that would be an
22 exception to the general rule. Why would that be an exception?
23 If it's--

24 THE COURT: I think it might be an exception to the
25 general rule, because one would hope that the law at least

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1 takes into consideration the way people normally act with each
2 other. And if this was an instance in which somebody said, you
3 know, X corporation is about to be given a patent on a cancer
4 cure, that's something where one might expect inquiry. But if
5 somebody with whom you have dealt with in the past before says
6 I tell you what I have done, I have taken X thousand dollars of
7 my money, and I have put it in this business, and you can come
8 in on the same terms --

9 MR. POPOFSKY: Well, I have three points on that. One
10 is I don't know that your cancer drug analogy, or any of those,
11 is actually -- to me those seem perhaps weaker, because that's
12 a question of inquiry. Your Honor used the word inquiry, but
13 my motion is not based on inquiry, it's based on verification.
14 I think there is a difference between inquiry and verification.

15 If someone says we have a cancer drug that's about to
16 be approved, you could inquire or you could look into what
17 stage of approval it's in, but you can't really know if it's
18 going to be approved or not. That's not something that you can
19 actually verify as a fact.

20 THE COURT: What's the best, strongest evidence of
21 whether somebody has or has not done something? Isn't it
22 whether he says this is what I've done?

23 MR. POPOFSKY: No, no, the best evidence is a piece of
24 paper showing it. If someone has invested, it would be easy
25 enough to see the check or the investment document. It depends

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1 on the nature of the investment, but there is always a piece of
2 paper. And here there would have been at least four pieces of
3 paper. So, I think it's easier than in your examples of what
4 other people have done, I think it's easier to verify. When
5 someone says to you I have done this, it's real easy to say,
6 OK, show me, show me something that indicates that you did it.

7 And respectfully I would turn your case question
8 around, because we are talking I think about an exception to
9 the general rule. I would say that plaintiff, if plaintiff is
10 going to adopt your Honor's argument and argue this
11 distinction, then plaintiff ought to come up with a case that
12 says something the defendant is alleged to have done is an
13 exception to the general rule, because we have a general rule.

14 THE COURT: Except you are the movant, you have the
15 burden.

16 MR. POPOFSKY: I do. But I have a general rule that's
17 been the law in New York for at least 120 years. There is
18 scores of cases that cite the general rule and apply it in all
19 sorts of different circumstances. As we say, I don't know if
20 there is a specific case in this circumstance, but I know the
21 general rule, and I think it fits this type of situation. It's
22 an easy thing to verify, and it went on --

23 THE COURT: How do you verify? He says I bought X
24 number of shares with my own money. You call up the
25 corporation and say --

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1 MR. POPOFSKY: Or you could ask him, show me your
2 check, the simplest thing. Show me a check or some
3 documentation of your investment. Everybody has documentation
4 of an investment. You don't give \$700,000 without getting
5 something back.

6 Now, these plaintiffs didn't ask for anything ahead of
7 time, but I think in Mr. Fisher's brief he says they received
8 some papers afterwards. It's not in the complaint, but he says
9 it would make sense if you are getting notes -- the allegations
10 are that they got promissory notes, so you would have
11 something. It would be easy enough. They have a promissory
12 note to Maloul and Lowy, so can we see a promissory note to
13 Berkowitz? Or can we see your check? Something.

14 THE COURT: Hindsight makes us all wise.

15 MR. POPOFSKY: And my third point is I don't think I'm
16 arguing against the way people normally act. I think this
17 general rule does consider the way people normally act. And I
18 agree that if somebody says to you I'm doing this, that's an
19 inducement. There is no question that that's an inducement.
20 The question is whether there is some minimal level of
21 verification required. And I don't think it's at odds with how
22 people normally act.

23 People are induced, but the law also holds some people
24 to some minimal level of verification. And that's what they
25 should have done. And, again, that's why the 18 months and the

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1 four separate occasions I think is significant. I think it
2 might be easier --

3 THE COURT: Is there anything in that period of time
4 which should have alerted the plaintiffs to the fact that
5 something was wrong?

6 MR. POPOFSKY: Yes. They allege that each time -- let
7 me find it. I will find the paragraph. They allege that each
8 time they were told money wasn't coming in and they needed to
9 invest more money in order to protect their investment. And
10 they had a lawyer who they claim they thought was their lawyer.
11 They were sending money to a lawyer, and they claim that they
12 thought he was their lawyer.

13 THE COURT: Acting sort of as an escrow agent?

14 MR. POPOFSKY: That's the allegation. So if that
15 happened, then on several occasions over 18 months they weren't
16 getting what they thought; they were told to put more in. They
17 could have gone to him. They could have gone to the three
18 different issuers. They could have gone to the lawyer, who
19 they thought was their own lawyer, and say what's going on
20 here.

21 The paragraph I was talking about is paragraph 39.
22 They said shortly before payments were due to plaintiffs
23 pursuant to the purported terms of the investments, plaintiffs
24 would receive word from the issuer defendants that the payments
25 could not be made on time, offering a higher rate of interest

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1 and the opportunity to purchase more stock.

2 So, in answer to your question, yes, I think things
3 did occur over the 18 months that put them on notice, and they
4 willfully shut their eyes over 18 months. They didn't care
5 about anything. They were just sending money blindly. I think
6 the law requires a minimal level above that.

7 We are not talking about the extent of due diligence.
8 That's what his brief talked about, and I understand completely
9 on a motion to dismiss you can't get into was the due diligence
10 adequate. But their complaint very clearly states -- and I
11 have quoted from it a couple of times in my reply brief -- we
12 relied solely, we asked for no documents, we saw no documents.
13 That I think you can hold as a matter of law is insufficient.
14 So, that's my argument on the verification.

15 I'd like to address 9(b) if I could as well briefly.

16 THE COURT: OK.

17 MR. POPOFSKY: There are purposes to 9(b) other than
18 the ones cited by the plaintiffs' counsel in his brief. One of
19 the purposes of 9(b) is to dispose of spurious fraud claims at
20 an early stage, that people can't just hurl fraud allegations
21 around without being forced to some specifics. And here there
22 are some incredibly easy questions to be answered that they
23 don't answer.

24 THE COURT: You're absolutely right, that the
25 complaint is woefully lacking in facts which have to be

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1 available to the plaintiffs to counter, the approximate dates
2 of these several transactions and so on.

3 MR. POPOFSKY: Well, your Honor, then I think I won't
4 say anything more on that.

5 THE COURT: Well, you do say something else. You say
6 but the plaintiff hasn't asked for leave to amend the complaint
7 and, therefore, but...

8 MR. POPOFSKY: I think they made a choice in
9 responding, your Honor. They chose to defend the validity of
10 this pleading, and they said all we have to do is say who made
11 the representations and they understand what we're claiming and
12 that's good enough. So I think you should hold them to their
13 choice. I think it would be improper to let them have it both
14 ways. They defend the pleading and now presumably say we would
15 like an opportunity to amend. I think they had an opportunity
16 to ask for it.

17 THE COURT: After you educated them on some of the
18 deficiencies. That's always the risk in making motions at this
19 stage.

20 MR. POPOFSKY: You are the judge, your Honor, and I
21 can't argue with you on that. So, unless you have any other
22 questions...

23 THE COURT: No.

24 MR. FISHER: Your Honor, Eric Fisher from Morgenstern
25 Jacobs & Blue for the plaintiffs. I'd like to start with the

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1 verification point made by my adversary.

2 I think that your Honor's focus on Mr. Berkowitz's
3 representation that he was coinvesting along with the
4 plaintiffs is of critical significance because I think it
5 frames the context for the whole fraud here.

6 My clients were not relating to Mr. Berkowitz as they
7 would to a broker or as they would to some third party who was
8 promoting an investment to them. They were relating to him, as
9 your Honor indicated, as someone with whom they had a
10 relationship that went back to the 1980s, who had made
11 recommendations to them in the past, and in whom they put a
12 certain amount of trust; and they were under the impression
13 that they were acting as a group in investing with
14 Mr. Berkowitz. And I think that in that context, the relative
15 lack of insistence on seeing paper verification of various
16 factual representations that were being made to them by
17 Mr. Berkowitz becomes clear, because they were not relating to
18 him as they would to a broker in which they said, well, let's
19 see some documents about that.

20 When Mr. Berkowitz said that he was investing
21 according to the same terms and conditions, and then proceeded
22 to lay out a series of facts that he thought made the
23 investment, or he claimed made the investment attractive, they
24 took him at his word. And, of course, the question of the
25 extent of due diligence is inherently variable and fact

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1 specific, and discovery ultimately will show that under the
2 circumstances of this relationship the plaintiffs' behavior was
3 reasonable. But that's not an issue for the motion to dismiss.

4 And in terms of your Honor's question about whether
5 there are cases in which individuals relied on someone's
6 recommendations as a friend, and statements about acts that
7 that person was taking, I haven't seen cases exactly on point,
8 your Honor, but I do know that all of the due diligence cases
9 cited by my adversary involve investors who were standing in
10 some kind of arms-length relationship to the person making
11 representations to them, and that was not the case here. This
12 is really a simple fraudulent inducement case.

13 With regard to the puffing issue, which Mr. Popofsky
14 just really rested on his papers, I think it's absolutely clear
15 that most of the allegations of misrepresentations in the
16 complaint relate to statements of fact.

17 For me perhaps the most glaring omission by
18 Mr. Berkowitz is the failure to disclose that he was receiving
19 fees from these issuer defendants. And, again, getting back to
20 the earlier point, if Mr. Berkowitz were receiving fees and my
21 clients knew that, then that would put them in a situation
22 where they might want to ask follow-up questions of
23 Mr. Berkowitz, because they would know that he had some vested
24 interest in soliciting their money. But they had no idea of
25 that. And clearly the fact that he was receiving fees and

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1 didn't disclose that is an omission of fact. Similarly, his
2 representation that these loans were personally guaranteed,
3 something which turned out not to be true, it's clearly a
4 statement of fact. So, I think that there are many material
5 misstatements of fact that are specified in the complaint.

6 In terms of the 9(b) point about which your Honor
7 expressed concerns, the complaint identifies fraudulent
8 statements, it explains why those statements were fraudulent,
9 it explains that in every instance Mr. Berkowitz was the
10 speaker, and it alleges in a general way that those statements
11 were made at or shortly before the time that the investments
12 were made, and it specifies the month and year of each
13 investment. What it does not allege is whether those
14 statements were made in face-to-face meetings -- some of them
15 were -- whether they were made by telephone call -- some of
16 them were. But aside from that level of granularity in the
17 detail, I do think the allegations are certainly specific
18 enough to put Mr. Berkowitz on notice of what this case is all
19 about, to allow him to prepare a defense, and with enough
20 specificity that it should be clear to the court that this is
21 not some effort to drag Mr. Berkowitz's name through the mud
22 but it is a complaint that is really grounded in fairly
23 specific factual allegations.

24 THE COURT: I'm going to deny the motion to dismiss
25 the complaint without prejudice to renewal. I am going to

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1 direct that the plaintiff file an amended complaint with as
2 much specificity as you can. What you do is you say three
3 transactions and this happened in all three. Well, use some
4 more paper and indicate to the extent you can the approximate
5 dates, if you don't have the exact dates; who was present when
6 the things were said; and whatever other detail you can furnish
7 as to the who, what, when and where.

8 I'm going to allow the defendant to renew the motion
9 addressed to the amended complaint, and also I allow both
10 parties to deal with the question that I started out with, and
11 that is what type of diligence is required in the context of
12 the relationship which existed as alleged here and where the
13 representations are something which the defendant said he
14 did -- not that he knew of or heard of or was told -- but
15 something that he did; and of course the omission of what he
16 did not say, which would have of course changed the nature of
17 the relationship as perceived by the plaintiffs and made more
18 relevant the classic cases that the defendant relies on where
19 somebody has the opportunity to read the prospectus or make
20 inquiry.

21 Tell me how much time you require to do any of those
22 things. The amended complaint, within three weeks?

23 MR. FISHER: Yes, your Honor.

24 THE COURT: Plaintiff to amend the complaint within
25 three weeks. Defendant may renew the motion --

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1 MR. POPOFSKY: 30 days, your Honor?

2 THE COURT: -- within 30 days.

3 MR. POPOFSKY: Thereafter.

4 THE COURT: 30 days after receipt of amended
5 complaint.

6 Both parties to file supplemental briefs within -- let
7 me give you a specific date -- amended complaint within three
8 weeks, I guess by January 24th. Defendant may renew motion
9 within 30 days after the receipt of the amended complaint,
10 which would be February 25. Both parties to file supplemental
11 briefs on March 18.

12 MR. POPOFSKY: I'm not sure, your Honor, if I renew
13 the motion on the 25th, then wouldn't the next step be for the
14 plaintiff to respond, rather than both sides?

15 It seems to me I would file the motion on the 25th
16 with my brief, he would respond the 18th, and then could I have
17 ten days to reply?

18 THE COURT: Do you really need that? Do you really
19 need the reply briefs? I mean I don't care, but, yes, do you
20 want to do that?

21 MR. POPOFSKY: Yes, your Honor.

22 THE COURT: All right. Defendant will renew motion
23 within 30 days; the plaintiff has 30 days to respond. That
24 takes us to March 25. Both parties file supplemental briefs by
25 April 25th. I will take it on submission. I don't think there

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1 is any need for further oral argument.

2 MR. POPOFSKY: I am just confused, your Honor, when
3 you say both parties. Is it not sequential?

4 THE COURT: No. What do you mean sequential?

5 MR. POPOFSKY: Your Honor, I'm not understanding. If
6 I make a motion, I submit a brief.

7 THE COURT: Yes.

8 MR. POPOFSKY: Then if he responds, he submits a
9 brief.

10 THE COURT: Yes.

11 MR. POPOFSKY: So then if I reply it's my reply. It's
12 not supplemental from both of us, is it? He has already
13 responded. I am just confused at to what you are ordering or
14 authorizing.

15 THE COURT: I think it's two issues. One is the
16 adequacy of the complaint as a matter of pleading, and the
17 other is the legal issue of whether in the context of a
18 relationship alleged by the plaintiffs, where the
19 representations allegedly made by the defendant of things which
20 he had done requires the same standard of vigilance that the
21 courts have required in the cases you cited.

22 MR. POPOFSKY: I understand that a hundred percent. I
23 would respectfully suggest that that be dealt with in our sets
24 of papers rather than then with another mutual set. It just
25 seems less workable to me, unless Mr. Fisher feels otherwise.

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1 MR. FISHER: Your Honor, I think what you have ordered
2 is that the defendants move to dismiss the amended complaint --

3 THE COURT: Yes.

4 MR. FISHER: -- that I file my opposition.

5 THE COURT: OK.

6 MR. FISHER: -- and then thereafter we submit to your
7 Honor the briefs specifically addressing the question about
8 what happens when a defendant makes a representation about an
9 act that he himself has done. Is that --

10 MR. POPOFSKY: It seemed to me to make more sense to
11 do it in the context of motion papers rather than a motion and
12 separate papers, but whatever your Honor wishes.

13 THE COURT: I couldn't care less. Tell me the dates
14 you would propose and the events you would propose.

15 MR. POPOFSKY: On your dates, your Honor, he amends by
16 January 24th, I make a motion to dismiss on February 25th.

17 THE COURT: Right.

18 MR. POPOFSKY: He responds on March 25th.

19 THE COURT: Right.

20 MR. POPOFSKY: And I reply April 15th.

21 THE COURT: OK. By April what?

22 MR. POPOFSKY: 15th.

23 THE COURT: OK.

24 MR. FISHER: I have no problem with that, your Honor.

25 THE COURT: OK. Very well.

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1 MR. POPOFSKY: Thank you, your Honor.

2 MR. FISHER: Your Honor, during this interim period is
3 discovery permitted to proceed? Because we are now talking
4 about a fairly lengthy additional briefing period on a
5 potentially renewed motion to dismiss.

6 MR. POPOFSKY: Well, your Honor, there are other
7 defendants as well, some have been served. I understand one
8 just answered. I would argue the whole point of trying to
9 dismiss this fraud claim is not to subject my client to that
10 kind of burden unnecessarily.

11 It's not my client's fault that they put in a
12 complaint that was, in your Honor's own words, woefully
13 deficient in specifics on fraud, so I think waiting all of
14 these years they could wait a couple more months.

15 THE COURT: Assuming that all of these deadlines are
16 adhered to, and that there is no request for a delay, I will
17 stay taking depositions. The question of whether to stay
18 document discovery is another point.

19 MR. POPOFSKY: Document discovery in some ways, your
20 Honor, is more burdensome than depositions.

21 THE COURT: Oh, I don't think in this case that would
22 be true, but you know the case better than I do. I will stay
23 discovery pending the completion of the schedule that we have
24 now agreed upon. Thank you, gentlemen.

25

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